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Wall St vs Main St

The Americans have a snappy name for everything. This week's title refers to the disconnect that often occurs between what is going on in financial markets and the headlines about the real economy. There is no such equivalent that I am aware of in the UK – The City vs the country, maybe? Throgmorton St (location of the old Stock Exchange) vs the High St doesn't have the same ring, does it?

One of the more frequent questions I am asked by clients is why equity markets are doing so well when, for example, the coronavirus news is so bad, jobs are being cut and the political background is so uncertain. I note it is also a recurring theme in the comments section of the Financial Times (sometimes more enlightening than the articles), along the lines of "this is all madness, a crash is inevitable". And yet, despite record numbers of coronavirus cases reported in the US over the weekend, we start the week on a positive footing.

At this juncture we can point to two main factors: liquidity and anticipation. Liquidity is being provided in bucket loads by the world's central banks through Quantitative Easing in the form of market purchases of (mainly) bonds. The current run rate is more than $5 trillion on an annualised basis, which compares with around $2 trillion at the peak (or should that be trough?) of the financial crisis. Even allowing for the fact that the global economy has expanded around 40% since 2009, that is a powerful tide of money. Investors also accumulated a formidable cash pile during the early stages of the coronavirus panic, with global holdings of money market funds rising by well over $1 trillion. These funds effectively represent cash, and therefore offer little by way of income, and so some of this is now being put to work in equity markets. There's a snappy name for this too: TINA, which stands for "There Is No Alternative" – in this case to equities and their income and capital gain-producing characteristics, essential if investors are going to have any hope of matching their long-term liabilities.

Liquidity alone, though, is not necessarily sufficient fuel. The second key factor is that the market is anticipating recovery. Although we have yet to receive what will undoubtedly be spectacularly poor Gross Domestic Product data for the second quarter, not to mention some grizzly corporate earnings, investors are working on the basis that overall activity bottomed out around three months ago. Goldman Sachs has been publishing its proprietary measure of global economic activity based on the severity of lockdowns since March. This troughed at -17% from January's peak in the second week of April, and suggests that we are now around 7.5% below that peak, or, put another way, more than 10% above the low point. Having said that, the bounce does seem to be flattening a bit as new local restrictions are put in place, which might dampen the markets' progress if it persists.

We can also observe the recovery in the high-frequency data that is increasingly on offer. One series that is not available to the public, but which we have access to, is Bank of America's weekly credit and debit card spending data in the US. I have been following the spending patterns for several months now, and a couple of weeks ago overall card spending by the bank's customers matched the figure from a year ago. One doubts that this means that the economy has recovered completely, and in all probability highlights the switch from cash to card as more purchases have shifted online (online spending by their customers has almost doubled year-on-year), but the underlying trend has been steadily improving for some time. Interestingly, credit card purchases are down, while debit card purchases are up, possibly a sign that consumers are spending the cheques that the government has been sending them. Two of the fastest growing categories have been Furniture and Home Improvement (although both lag a long way behind Online Electronics), no doubt as people have settled in for a long period at home and no longer have an excuse to put off those odd jobs around the house.

It should also be mentioned that the recovery in equity markets has been far from evenly spread, something that is also apparent in the card spending data. Steady growth companies and those whose business models have been beneficiaries of lockdowns have steamed ahead at the expense of those more directly affected by the coronavirus. To some this constitutes a bubble ripe for popping, but, at the risk of setting myself up for a fall, there are plenty of reasons to suggest that this is not the case. Empirical Research points out that at the peak of three previous cycles for the group of US companies it classifies as Big Growers (the 1960s boom in computer mainframes and pharmaceuticals, the Nifty Fifty of - supposedly - reliable brands in the early 1970s, and then the Tech Boom at the turn of the millennium), the average free cash flow margin was a puny 5.5%. Today's group boasts a free cash flow margin of 18%, boosted by the asset-light model that favours many Technology companies. Furthermore, those cash flows are more highly valued by investors owing to a low real discount rate and the fact that the long-term growth outlook for the whole economy is unexciting. Of course, the risk is that those margins are unsustainable, either owing to competition or regulation, and it is one that we are well aware of and continue to monitor accordingly.

Speaking of bubbles, it reminds me to give a shameless plug for Investec's excellent series of podcasts, which can be found if you search for Investec Focus Radio SA. I have just listened to my colleague Max Richardson's interview with James Anderson, the lead manager of the Scottish Mortgage Investment Trust (published on June 18th). SMIT is part of the Baillie Gifford stable of funds which are collectively the largest public owners of shares in Tesla, the ground-breaking and equally controversial manufacturer of electric vehicles. It has an approach to long-term investment that will challenge many of your preconceptions, and the podcast is worthy of an hour of anyone's time who has an interest in investing. One of the topics concerns investment bubbles and how they can be a positive force even if some investors end up losing their shirts. Anderson's critique of the CFA Institute (Chartered Financial Analyst) might also raise a few eyebrows.

I would also recommend listening to Howard Marks (April 23rd) and Dan Crosby's "Investing rules for uncertain times" (June 4th). He highlights (amongst plenty of other good advice) that one should not be constantly checking one's portfolio valuation if investing for the long-term, something with which I wholeheartedly agree. In my review of the first half of 2020 I use the idea of a jungle explorer who emerges after six months of no contact with the outside world to check his portfolio. Last week I updated a series of charts which include performance of the FTSE Private Client Indices. The balanced mandate figure was 0.0% for the year-to-date! All that stress for nothing. It's also a reminder that, for the majority of our clients, returns are derived not just from the headline-hogging equity markets, but also from bonds and alternatives, asset classes that are rarely afforded much airtime.

Last week's Economic Highlights

FTSE 100 Weekly Winners

Persimmon Plc	16.6%
GVC Holdings PLC	11.1%
Barratt Developments PLC	10.9%
Fresnillo PLC	9.9%
Antofagasta plc	6.7%
Scottish Mortgage Investment Trust Plc	6.7%
Berkeley Group Holdings plc	6.4%

FTSE 100 Weekly Losers

Imperial Brands PLC	-5.8%
British American Tobacco p.l.c.	-6.0%
Standard Life Aberdeen	-6.0%
Ashtead Group plc	-6.3%
ITV PLC	-6.4%
International Consolidated Airlines Group SA	-6.6%
DS Smith Plc	-7.0%

FTSE 100 Index, Past 12 Months

Source:FactSet

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